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IN THE

Supreme Court of the United States

OCTOBER TERM, 1963

No. 717

JOHN S. GORSUCH, *Petitioner*

v.

PROVIDENT SECURITY LIFE INSURANCE COMPANY,
Respondent

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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Petitioner prays for a writ of certiorari to review the judgment of the United States Court of Appeals for the Ninth Circuit in the above-entitled case.

OPINIONS BELOW

The opinion of the district court is unreported. It is found in Appendix A, and at pages 38-41 of the record. The opinion of the court of appeals is reported at — F.2d —, and is found in Appendix B.

JURISDICTION

The judgment of the court of appeals was entered October 1, 1963 (App. B). The jurisdiction of this Court is invoked under 28 U. S. C. § 1254(1).

QUESTION PRESENTED

Whether the power of a state's legislature to establish pre-requisites to a valid merger of its domiciled corporations can be both eliminated and rewritten by the invocation of federal common law concepts by a court of appeals?

STATUTES INVOLVED

The statutory provisions involved, all of which are set forth in Appendix C, are:

Arizona Revised Statutes, Sec. 10-344(C).
Arizona Revised Statutes, Sec. 10-345(A).
Arizona Revised Statutes, Sec. 10-346.

STATEMENT

Petitioner, an Ohio stockholder of United Security Life, an Arizona life insurance corporation, filed two separate and distinct actions for the benefit of United. One was designed to recover United's assets while this action attempts to preserve its existence.

The first, a shareholder's derivative suit, sought the recovery from American Security Investment Company of $314,794.19 of United's cash, bonds, and mortgages unlawfully taken by American to "pay" for the latter's purchase of a 38.79 per cent controlling stock interest in United.

While such action was pending, American caused a United shareholders' meeting to be called at which it voted the 38,799.89 shares of United stock in favor of merging United into Provident Security Life Insurance Company. (R. 9, 39). Of the 100,000 shares of United stock outstanding, 75,723 voted in favor of the merger. (R. 9, Ex. 1). Excluding the 38,799.89

shares voted by proxies for American, the total vote in favor of the merger was 36,923.11 shares. If the total outstanding shares of United be deemed not to include American's 38,799.89 shares, then only 36,962.11 votes out of a total of 61,200.11 were in favor of the merger. Arizona Revised Statutes, Sec. 10-344(C) requires, as a condition precedent to a lawful merger, the favorable vote of two-thirds of the outstanding stock. Therefore, the United-Provident merger could only comply with the statute if the 38,799.89 share votes cast by American's proxies were valid.

Thereafter, the stockholder's derivative action was tried, and the district court found as fact that American had unlawfully taken $314,794.19 of United's cash, bonds, and mortgages as recited above. *Gorsuch* v. *United Security Life*, et al., Civil No. 2974, filed by the district court on June 21, 1960. Judgment was entered against American and thirteen individuals. (R. 40). American and eight of the individuals failed to appeal, and the judgments against them became final in 1960 and 1961.

The second suit filed by Petitioner on February 12, 1962, was the instant action. Jurisdiction was founded on 28 U. S. C. § 1332. This action challenged the validity of the United-Provident merger described above. Both parties filed motions for summary judgment, and District Judge George H. Boldt ruled that the challenged merger had failed to comply with Arizona's statutory pre-requisites for a lawful merger in four particulars. In so doing, the district court, sitting as a court of equity, completed the task of returning United to its financial and legal status just prior to the $ 314,794.19 raid by American. It had, in short,

restored United's property *and* its life which had been taken from it by American's actions.

The four grounds upon which the district court relied in ruling that the United-Provident merger had not complied with Arizona's statutory pre-requisites for a lawful merger were:

(1) American's acquisition of the 38,799.89 shares of United stock was improper and invalid, and therefore the two-thirds majority of the outstanding stock in favor of the merger required by Arizona Revised Statutes, Sec. 10-344(C) was lacking.

(2) American was not the record owner of the 38,799.89 shares of United stock on the date of the merger vote, and therefore its voting of such shares was invalid.

(3) Assuming a valid two-thirds favorable vote of the United stock, all of the assets of United did not vest in Provident as required by Arizona Revised Statutes, Sec. 10-346.

(4) Assuming a valid two-thirds favorable vote of the United stock, a condition precedent to a valid merger was not met in that no copy of the merger agreement was filed with the county recorder as required by Arizona Revised Statutes, Sec. 10-345(A):

The court of appeals reversed the district court holding that:

(1) American had such title as to allow it to validly vote the 38,799.89 shares of United stock for a merger, and no constructive trust could exist in United's favor so as to invalidate such a merger vote prior to a judicial declaration thereof.

(2) The fact that American was not the record owner of the 38,799.89 shares of United stock is overcome by Arizona Revised Statutes, Sec. 10-231(A)(1) providing that title to stock shares passes upon delivery of such shares endorsed in blank.

(3) The merger agreement "in substance" does not provide for the retention, by United, of assets which should have been transferred, and Arizona Revised Statutes, Sec. 10-345(A) was not violated.

(4) Assuming the merger was valid in all other respects, the failure to record the merger agreement is overcome because there was a "de facto" merger in 1959.

REASONS FOR GRANTING THE WRIT

The court of appeals refused to follow Arizona statutes which spell out the pre-requisites for a valid merger of Arizona corporations. In so doing it has decided an important question of state law (the requirements for validity of a merger) in conflict with state law, and has thereby taken from Arizona's legislature the power to establish pre-requisites before a merger can take place. Its decision violates both the spirit and the substance of *Erie R. Co.* v. *Tompkins*, 304 U. S. 64.

The issue here is important not only to United, which will be deprived of its corporate life if there is no review, but also to Arizona as well. The reason is that the four statutory requirements for a valid merger which were glossed over or rewritten or eliminated by the court of appeals were each intended to fulfill an important public need in the judgment of the Arizona legislature. Thus, the two-thirds favorable vote, needed

before a merger can occur, protects minority shareholders from a simple majority determined to merge the corporation for their own interests. The rule that one be the record owner of stock before being entitled to vote such stock is essential if other shareholders are to have sufficient notice to challenge invalidly issued shares and have meetings conducted in orderly fashion. The requirement that all assets and all liabilities vest in the surviving corporation is vital to the protection of creditors of the merged corporation. And the requirement that the merger agreement be recorded in the county recorder's office gives the public and creditors notice of the terms of the merger.

More specifically the court of appeals has vitiated Arizona's pre-requisites for a valid merger as follows:

1. There is no Arizona law holding that American's title to the 38,799.89 shares of United stock was sufficient, in a case where United's assets had been taken to "pay" for the stock, to allow it to vote such stock and thereby merge United out of existence. Nor has the court of appeals cited any. Instead it has said that American's title as against the sellers of the stock was good. But it is not the sellers who are complaining. It is a shareholder of United who seeks on United's behalf to have United's unlawful merger held void. Consequently, American's title as against Kelly, the seller, is not in issue. Also, there is no Arizona law in support of the court of appeals statement that a constructive trust in favor of United could not exist at the time of the vote on the merger unless there had been a judicial declaration thereof.

If the court of appeals' rule as to the validity of American's title is allowed to stand, then Arizona Re-

vised Statutes, Sec. 10-344(C) means very little. Why? Because all the minority shareholders desiring merger need do is buy more of the corporate stock, "pay" for it with the corporation's assets, and then vote such shares in favor of a merger.

2. In addition to ruling that the necessary two-thirds favorable vote did not exist because American's title to the stock was defective, having used $314,794.19 of United's money and mortgages to "pay" for it, the district court also held that the vote by American was invalid since it was not the record owner of the 38,799.89 shares of United stock. This has not been avoided by the court of appeals' statement that title to stock endorsed in blank is passed when delivery is effected. The necessity for record ownership in order to vote corporate stock rests on the need of adequate notice to the other shareholders and the corporation. Therefore, assuming arguendo that American was able to acquire good title as against the other shareholders and United when it used $314,794.19 of United's cash and mortgages to "pay" for its purchase of the 38,799.89 shares of United stock, such a conclusion does not obviate the requirement that it be the record owner of the stock in order to vote for a merger which terminates United's existence.

3. And Arizona Revised Statutes, Sec. 10-346, requiring that all assets of the merged corporation vest in the surviving corporation, and that the rights of creditors against the property shall be preserved unimpaired, has been negated. This is so because paragraph 11 of the merger agreement provides that consenting United shareholders *shall be entitled* to any recovery obtained as a result of Petitioner's $314,794.19 action on behalf of United. The court of appeals

ruled that "in substance it does not provide for the retention, by United, of assets which should have been transferred, but for the distribution, to consenting United stockholders, of the monetary value of a transferred asset of doubtful and unknown value, if it later developed that it had substantial value." But surely the fact that an asset is of unknown value at the time of a merger does not free it from the scope of the section. Also, it is beside the point to say the assets pass to the surviving corporation when the statute requires that it vest there. And how can the rights of creditors be preserved unimpaired when the court of appeals concedes that the paragraph does provide for "distribution" of the recovery to United shareholders consenting to the merger? Proof that the rights of creditors are impaired is shown by the court of appeals statement that they may have to litigate the matter later.

4. Arizona Revised Statutes, Sec. 10-345(A) requires that the merger agreement *shall* be recorded in the county recorder's office, and that when such recording takes place, the "consolidation shall *thereupon* be deemed consummated and the separate existence of the constituent corporations to have ceased, and the consolidated corporation *shall become* a single corporation. . ." That is, the merger is not consumated until such recording. The reason, of course, is to give the public notice. *Lewis* v. *State*, 32 Ariz. 182, 256, 1048, 1050. Here there was no recording of the merger agreement.[1] Yet the court of appeals has nullified this pro-

[1] Nor is the issue one of tardy recording. The district court's opinion herein was filed on March 28, 1962, and judgment was entered on May 15, 1962. (R. 41,44). The recording of which the court of appeals speaks occurred on May 23, 1962, and was presented in an avowal by Provident's counsel

vision, stating that there was a de facto merger.[2] But, as the court of appeals acknowledged, Arizona has no doctrine of de facto mergers.

The district court faithfully applied four of Arizona's statutory requirements for a valid merger. The court of appeals has nullified or negated each of the four. As a result, Arizona is the only state, known to Petitioner, where one can take $314,794.19 of a corporation's money to buy a controlling stock interest in that corporation, and then vote such stock to merge the corporation out of existence when sued for the $314,794.19. If such a rule were sanctioned by Arizona's legislature, it is doubtful that this Court would permit it to live under the Fourteenth Amendment. But here such a rule has been imposed upon Arizona by a court of appeals.

Arizona's statutory requirements for a valid merger show by their content and tenor that the Arizona legislature would not authorize the merger of two of its corporations underneath a bridge in the dark of night. Yet here the court of appeals, reversing the district court, has validated an attempted Arizona merger where there was no recording of the merger agreement with the county recorder, no vesting of all of the merged corporation's assets in the surviving corporation, no two-thirds favorable vote unless shares "paid" for with $314,794.19 of the merged corporation's money are counted, and no two-thirds favorable vote unless shares

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during the appeal. Thus, the recording occurred after the merger had been judicially declared void and invalid.

[2] Under the de facto doctrine, there is no statutory requirement for a valid merger which can remain alive in the face of an illegal merger which has existed for several years during litigation.

voted by one not the record owner of the stock are counted.

This is not simply a case where the court of appeals has erred. It is one wherein the power of a state to regulate and control the conditions for merging its corporations has been nullified. *Erie R. Co.* v. *Tompkins, supra,* was not just an academic statement of legal principle. It was a rule of law having force and content. But more than publication is required to impart force. The sure knowledge by lower courts that refusal to follow will result in review here is also necessary.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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APPENDIX A

UNITED STATES DISTRICT COURT FOR THE DISTRICT OF ARIZONA

Civil Action, No. 4046
Phoenix

JOHN S. GORSUCH, *Plaintiff*,

vs.

PROVIDENT SECURITY LIFE INSURANCE COMPANY, *Defendant.*

Memorandum Decision and Order Re Motions For Summary Judgment and Default

MEMORANDUM DECISION AND ORDER RE MOTIONS FOR SUMMARY JUDGMENT AND DEFAULT

This action challenging the validity of the United-Provident merger of 1959 was commenced following entry of the Court of Appeals opinion, 295 F.2d 909, in Cause No. 2974 of this Court, Gorsuch v. United Security Life. In that opinion the necessity of direct rather than collateral attack on the merger was indicated.

Both plaintiff and defendant have filed motions for summary judgment and plaintiff has filed a motion for default judgment based on defendant's failure to answer within the period prescribed by law. The motions have been submitted for decision on the record and written memoranda. Leave to present oral argu-

ment was extended but declined by counsel. From a review of the pleadings, affidavits and memoranda supporting the motions the following are shown as undisputed facts:

1. Approving votes of two-thirds of the issued stock of both United and Provident were required to authorize the merger. Only the vote of United stock is challenged, as to which: (a) American Security Investment Company by proxy voted 38,799.89 shares of United stock; (b) at the time of the vote ASIC was not the record owner of the stock which then stood in the name of Kelly; (c) on the United corporate record ASIC was not entitled to vote that stock and the vote thereof was invalid; (d) without valid vote of the Kelly stock the necessary two-thirds majority required for approval of the merger was not and could not be provided.

2. Assuming a valid vote of all United stock, the Arizona statutes relating to mergers were not complied with in that (a) the merger certificate agreement was not filed in the office of the county recorder of each county in which one of the constituent corporations at the time had its principal office as required by A.R.S. Sec. 10-345(A); (b) all assets of United did not pass to the consolidated corporation as required by A.R.S. Sec. 10-346.

3. The Kelly-ASIC stock transaction was ineffective by reason of improper and invalid acquisition of the assets of United by ASIC.

On the record there is no controversial issue as to any of the above stated facts. Item 1, in itself and standing alone, requires summary judgment as prayed for by plaintiff. The same is true as to item 2. These

items are established by unimpeached documents, uncontradicted affidavits and pleading admissions.

Item 3 above is established by the judgment against Kelly and others in Gorsuch v. United Security Life, supra, made final by dismissal of the appeals of those defendants. It will be further established by the judgment and additional findings and conclusions to be entered in the same cause.

For the reasons stated the summary judgment motion of plaintiff is hereby granted and the motion of defendant for summary judgment denied.

Plaintiff's motion for default is well taken on the basis of the cited authorities and as a matter within the discretion of the trial court. Accordingly, said motion is hereby granted.

To preserve the corporate status quo of Provident until the summary judgment above ordered becomes final on appeal or by failure of timely appeal, said judgment shall not become effective for any purpose, other than as to the status of Provident, United and their shareholders in cause #2974, supra, until further order of the court.

A form of summary judgment conforming to the foregoing rulings may be presented for signature and entry at the convenience of counsel.

Dated at Phoenix, Arizona, this 28th day of March, 1962.

/s/ GEO. H. BOLDT,
U.S. District Judge.

[Endorsed]: Filed March 28, 1962.

APPENDIX B

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

No. 18,307
Oct. 1, 1968

PROVIDENT SECURITY LIFE INSURANCE COMPANY
Appellant,

vs.

JOHN S. GORSUCH, *Appellee*

Appeal from the United States District Court for the District of Arizona

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Before: BARNES, HAMLEY and JERTBERG, Circuit Judges

HAMLEY, Circuit Judge:

John S. Gorsuch, a stockholder in United Security Life (United), brought this action to have declared void a merger agreement entered into between United and Provident Security Life Insurance Company (Provident). District court jurisdiction is based on diversity of citizenship. Judgment was entered for plaintiff and defendant, Provident, appeals.

Gorsuch first attacked the validity of this merger during the course of the appeal to this court in *Niesz v. Gorsuch*, 9 Cir., 295 F.2d 909. That was a stockholder's derivative action in which Gorsuch, suing on behalf of United, sought to recover $314,794.19 for

the corporation from certain individuals all but one of whom were or had been stockholders, directors or officers of United.

After the complaint had been filed in that action, a merger was consummated whereby Provident was to continue in existence as the surviving corporation and United was to cease to exist. The derivative action nevertheless proceeded as if United continued in existence, Provident not being added as a party. After trial, the trial court, among other things, set aside, as inadequate, a verdict in the sum of $20,000 against certain defendants, and entered judgment in the sum of $314,794.19 against these and certain other defendants. In the alternative, the trial court determined that the jury verdict was advisory only, and entered findings of fact and conclusions of law supporting its judgment for plaintiff in the amount indicated.

In that case the trial court made no specific findings with reference to the merger, but did find and conclude that United was and is a corporation and citizen of and domiciled in the State of Arizona. On appeal the defendants in that case challenged this finding, contending that United was no longer in existence and that neither United nor Gorsuch had capacity to continue with the lawsuit.

In resisting this challenge, Gorsuch contended, on appeal, that the merger was not valid because American Security Investment Co. (American) which voted 38.79% of United stock in favor of the merger assertedly did not have good title to that stock. Rejecting that contention we held that American had prima facie title to the stock and that if Gorsuch wanted to contest the legality of the merger "he should have done